PWM Investment Strategy

Risk free rate...really ?

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Executive summary (balanced AA)

Fixed Income

CURRENT 45%

Cash 13%
Gov bonds 9%
Credit 18%
EM Debt LC 5%

Currencies

OPTIMAL BLEND:
Reference currency
Gold

Equities

CURRENT 35%

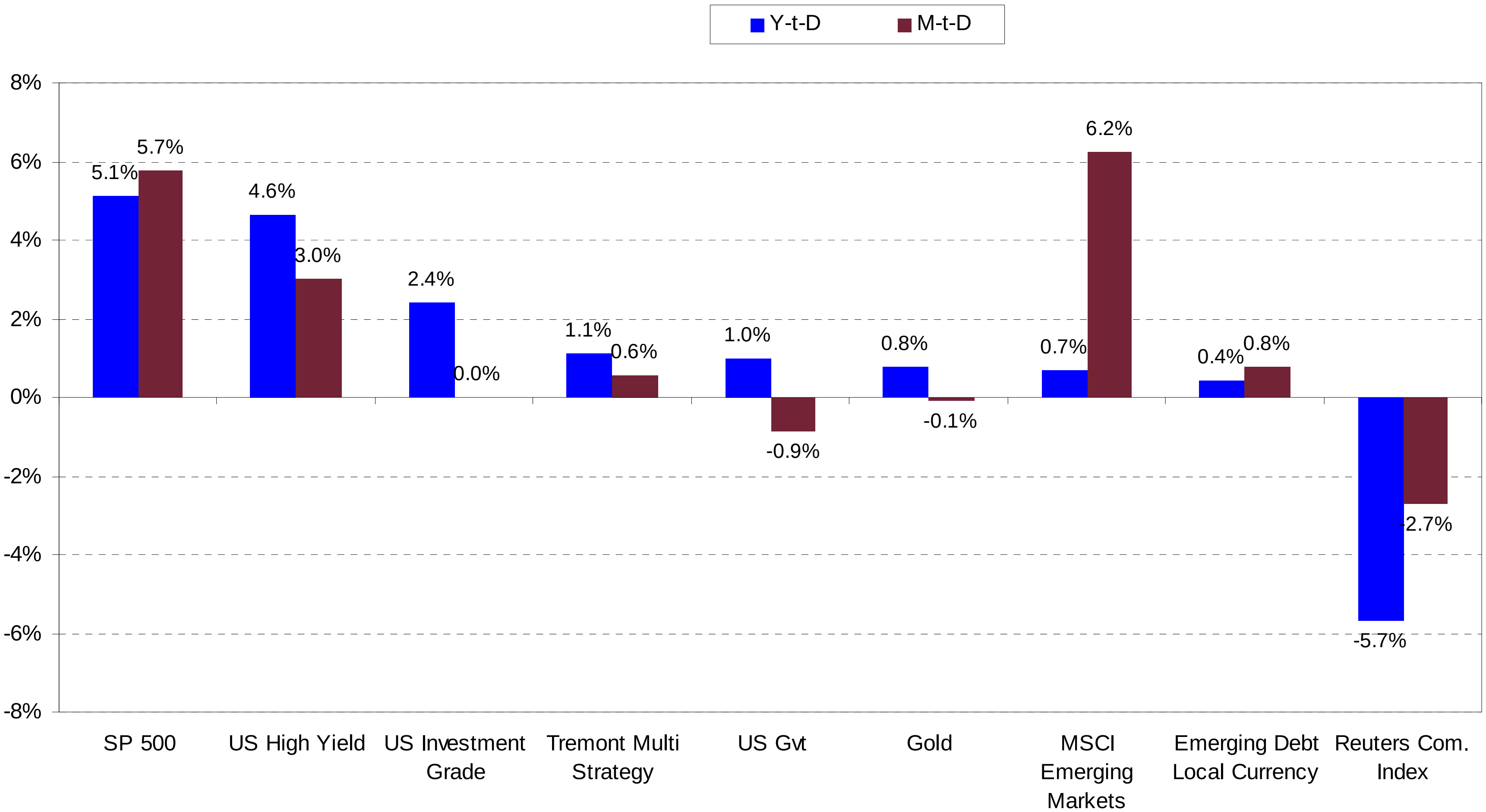
Equities 30%
L/S equity 5%

Alternatives

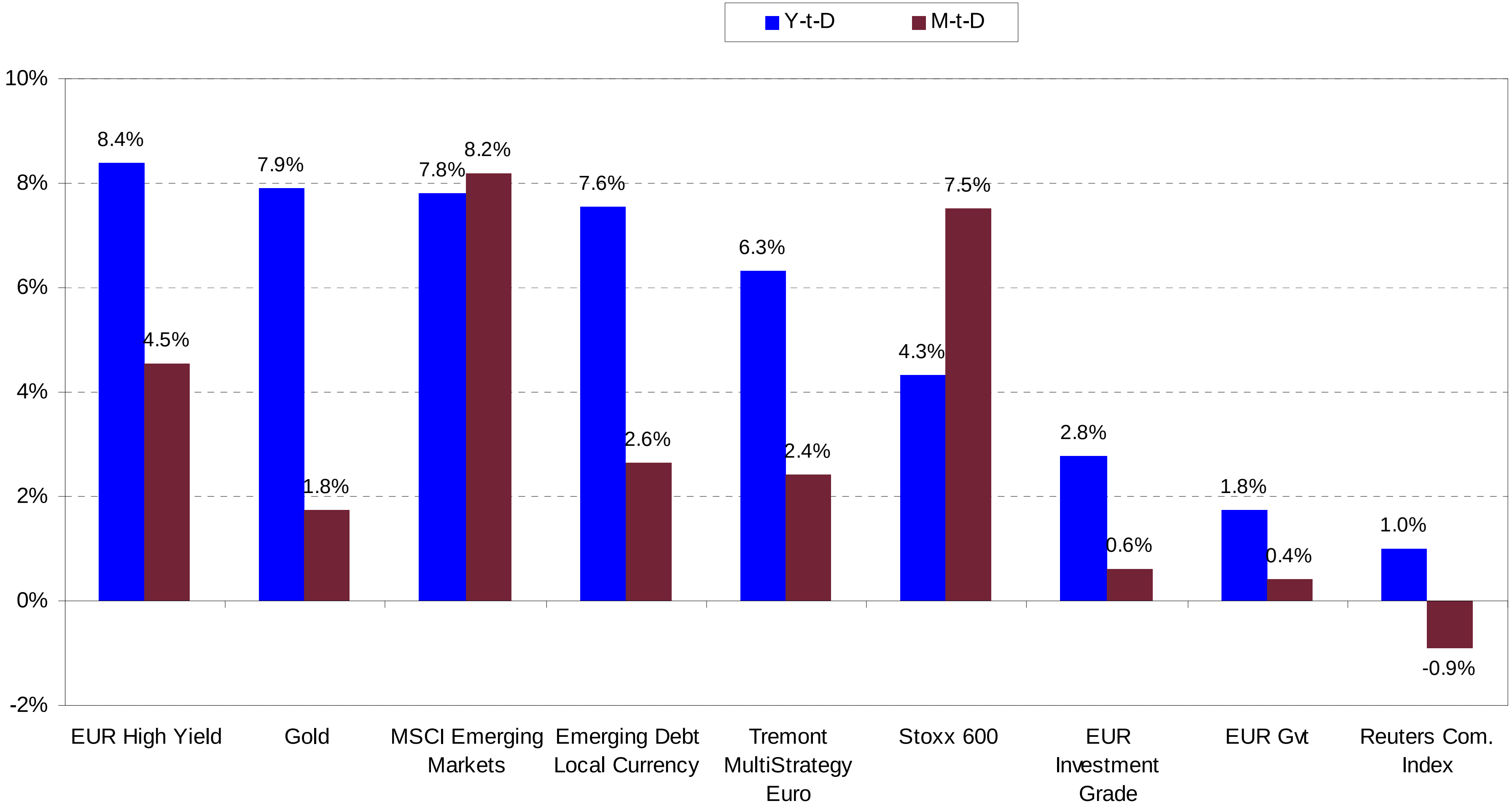
CURRENT 20%

Multi-Strat HF 15%
Gold 5%

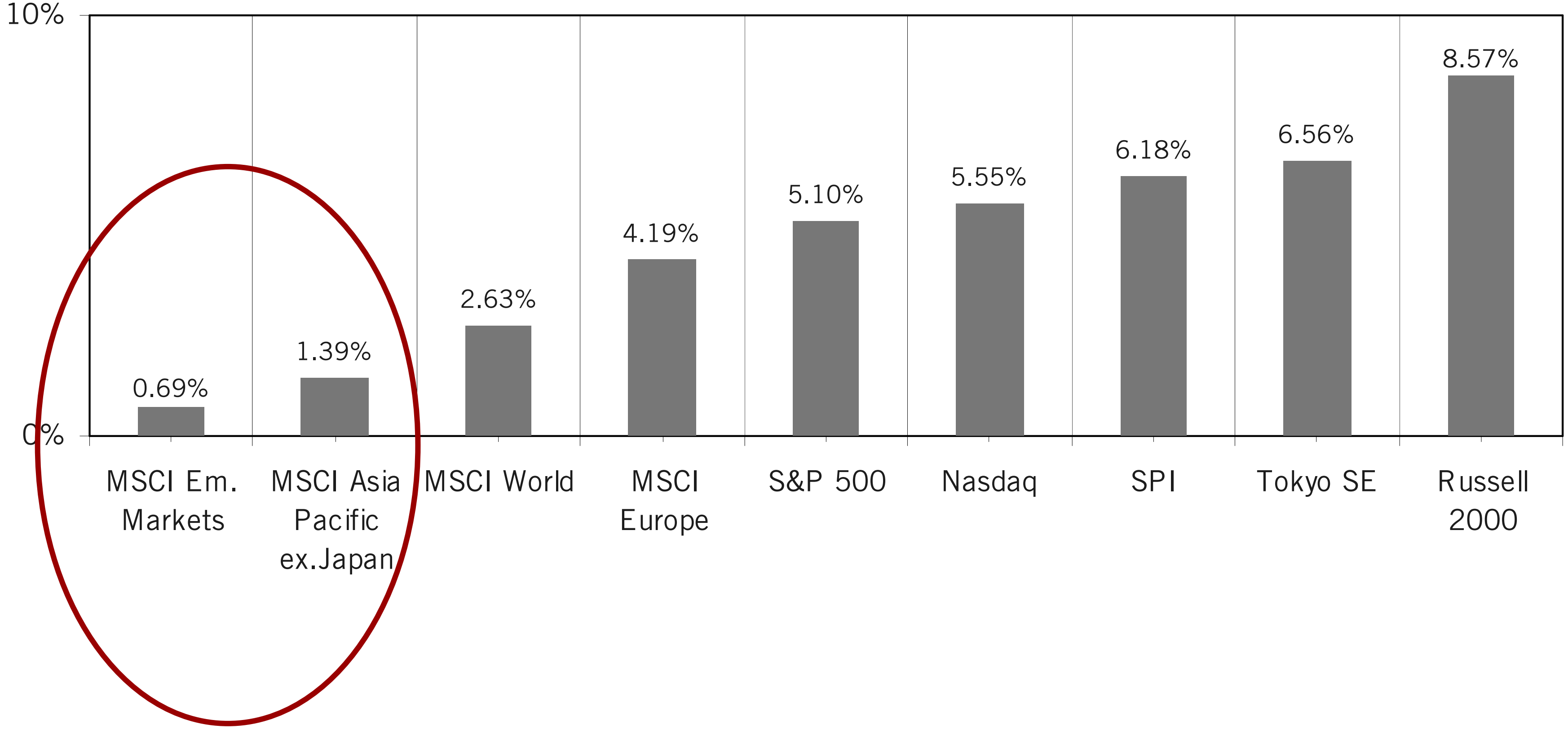
Assets returns (as at 26-3-2010) in USD



Assets returns (as at 26-3-2010) in EUR

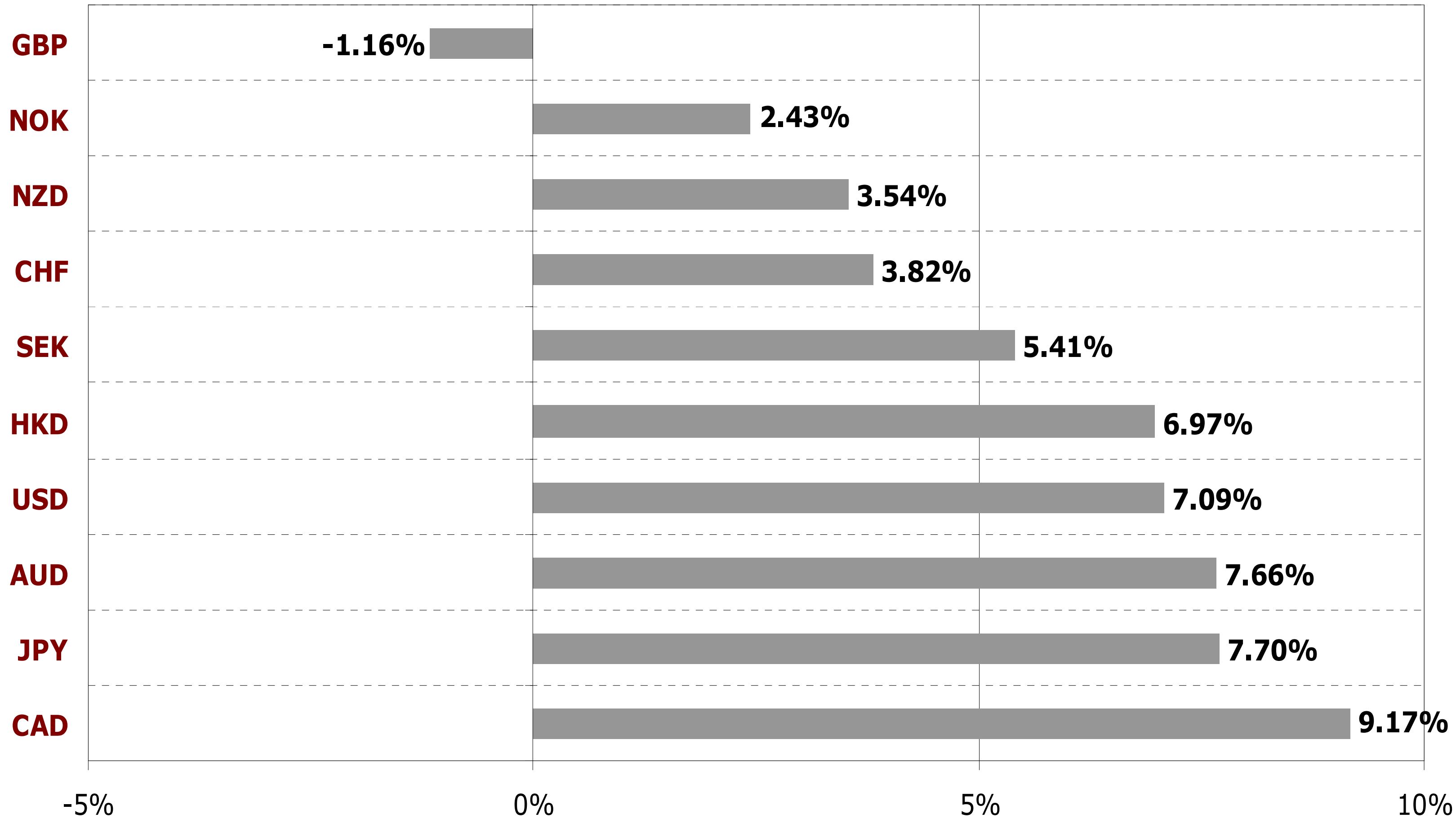


Stock markets (as at 26-3-2010)



Total Return Indices except Nasdaq and Russell 2000

Currencies vs EURO y-t-d



Latest developments

- Investors' attention has moved from the US and its housing/banking debacle to the (European) sovereign crisis. The Greek issue has exposed the weak European institutional setup and the difficulty for Europe to grow.

- Some relationships, we had all become accustomed to, have now broken, requesting more discrimination among asset classes. Economic fundamentals have become the main factor.

- The Greek crisis was a catalyst at is concentrated investors' attention on the government finances resulting from the 2009 governments stimulative plans. Exit strategies are constrained by government finances now.
  - The Fed will maintain rates low for a "extended period of time" and the ECB will not alter its minimum rating eligible for collateral lending to commercial banks.

- Equity markets have behaved well since the February lows as:
  - Currencies have absorbed almost all the sovereign shock
  - As fiscal policy is altered, monetary policy has to remain unchanged not to penalize growth.
  - In that case, equity markets are left with an "extended" period of low interest rates, rising earnings and rather low valuations.
  - This scenario is valid as long as fiscal policies to not threaten economic growth.

Past relationships have broken

- The weak dollar/strong S&P (strong gold) relationship does not hold anymore. Global top-down factors guided markets behavior from last year. Not anymore.
- The S&P 500 was able to pass its January high with a strong currency. A weak USD is not requested anymore for equity markets to perform as the market concentrates on growth and earnings.

USD PER EUR AND S&P 500

Economic growth paths

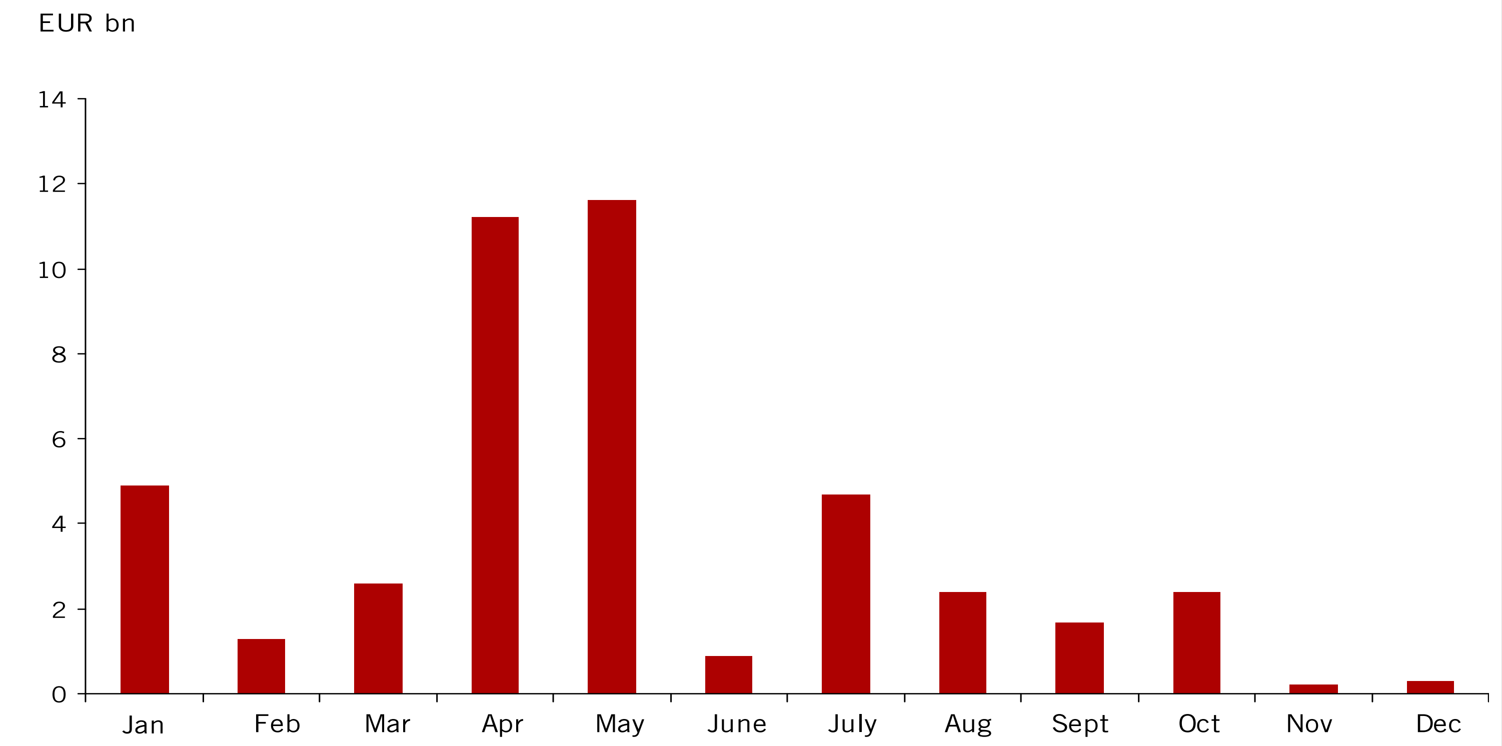
The Greek crisis

- In a rare stand of independence, EU Commission President **Barroso defied Germany** by coming out in favour of peer financial assistance being granted to Greece.
- The March 25-26 March EU meeting, result was a **mixed-bag solution** being cobbled together, involving an IMF stand-by arrangement coupled with a bilateral loan or guarantee.
  - Greece could rapidly have access to a **stand-by arrangement**. The practice in recent previous similar cases (Hungary, Latvia, Romania, Ukraine) has been for an amount between 10 and 12 times the relevant country's quota which, in Greece's case, would constitute a sum between EUR10bn and EUR12bn.
  - An **additional rapid special loan** could be also put in place. Thus EUR20bn could be made available quickly via the IMF.
  - **Interest rates** paid on such facilities are progressive, ranging between 1.5% and 3.5%, well below terms and conditions on the last issue (6.2%).
- Greece has re-gained the ability to access to financial markets but at a high price.
- **The long-term issue remains unresolved as financing cost remain very high in regard to nominal growth This is deflationary.**

In 2010, April and May will provide acid tests

- It was urgent for European leaders to rapidly come to an agreement as the debt refinancing schedule was tight.
- Greece weighted cost of 2010 bond issues is 6.18%.

REDEMPTION SCHEDULE OF GREECE CENTRAL GOVERNMENT DEBT



Swiss economic recovery likely to remain strong

- **Inventories** still currently being reduced at a rapid pace: reliable data are missing but pace of destocking seems to have reached -1% to -1.5% of GDP in H2 09. Bullish for output growth in the future
- No need to tighten **fiscal policy**
- **Employment** already in recovery mode
- Very favourable **wealth** effect, via higher house prices and rebounding financial markets
- Very low domestic **interest rates**, strong demand for new lodging in most areas
- The ongoing **world recovery** should continue to support Swiss exports, despite a stronger Swiss franc

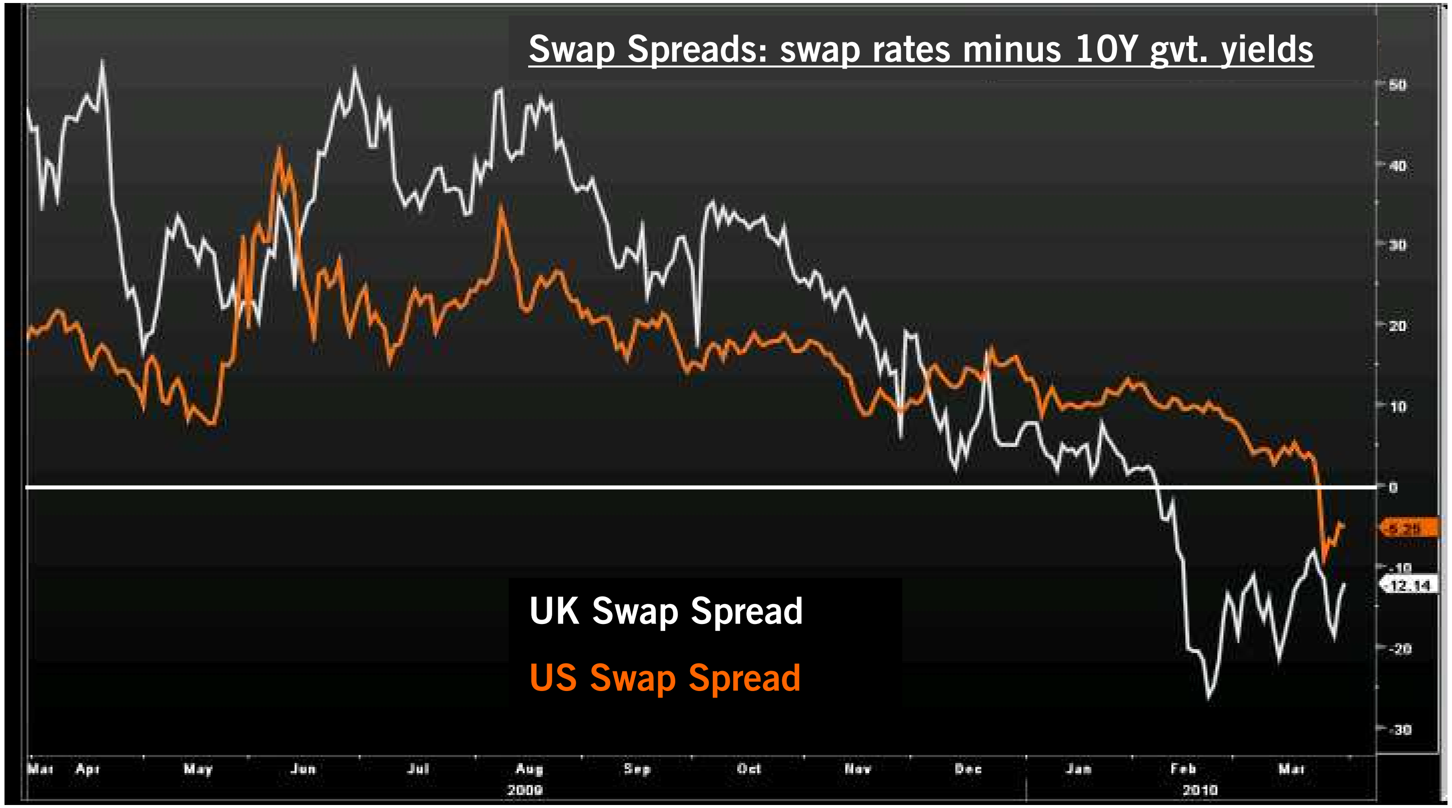
➔ We believe growth will remain healthy over the coming quarters. We expect **GDP to grow by +2.3% in 2010** (consensus: 1.5%, SNB: 1.5%, SECO: 1.4%)

Macro outlook: summary

- The European economy remains driven by the industrial sector meanwhile the US one could see a rebound in consumption.
- Emerging economies, lead by China have now to manage their growth path by fighting against inflation pressures.
- Differences among the different regions/countries are increasingly apparent, leading to differentiation in currencies and yield levels.
  - Emerging markets – Developed markets
  - US – Europe
  - Europe – Switzerland
- We expect these differentiating trends to remain in place as:
  - Germany does not accept a direct bailout, let alone a relative loss of competitiveness through higher inflation.
  - Leading to a real economic adjustment in weaker European countries keeping the whole Eurozone growth near 1%.
- These adjustments are structural and will unfold over several years.

Risk free rate: a concept ?

- Given the deterioration in public finances, the concept of risk free rate has to be reworked. Gilts rates rose above swap rates in February 2010.
- For the first time, 10Y swap rates are lower than 10Y government rates. Recent auctions were not so well bid, leading to questions about supply issues.
- The US government borrows at…swap +4bps !



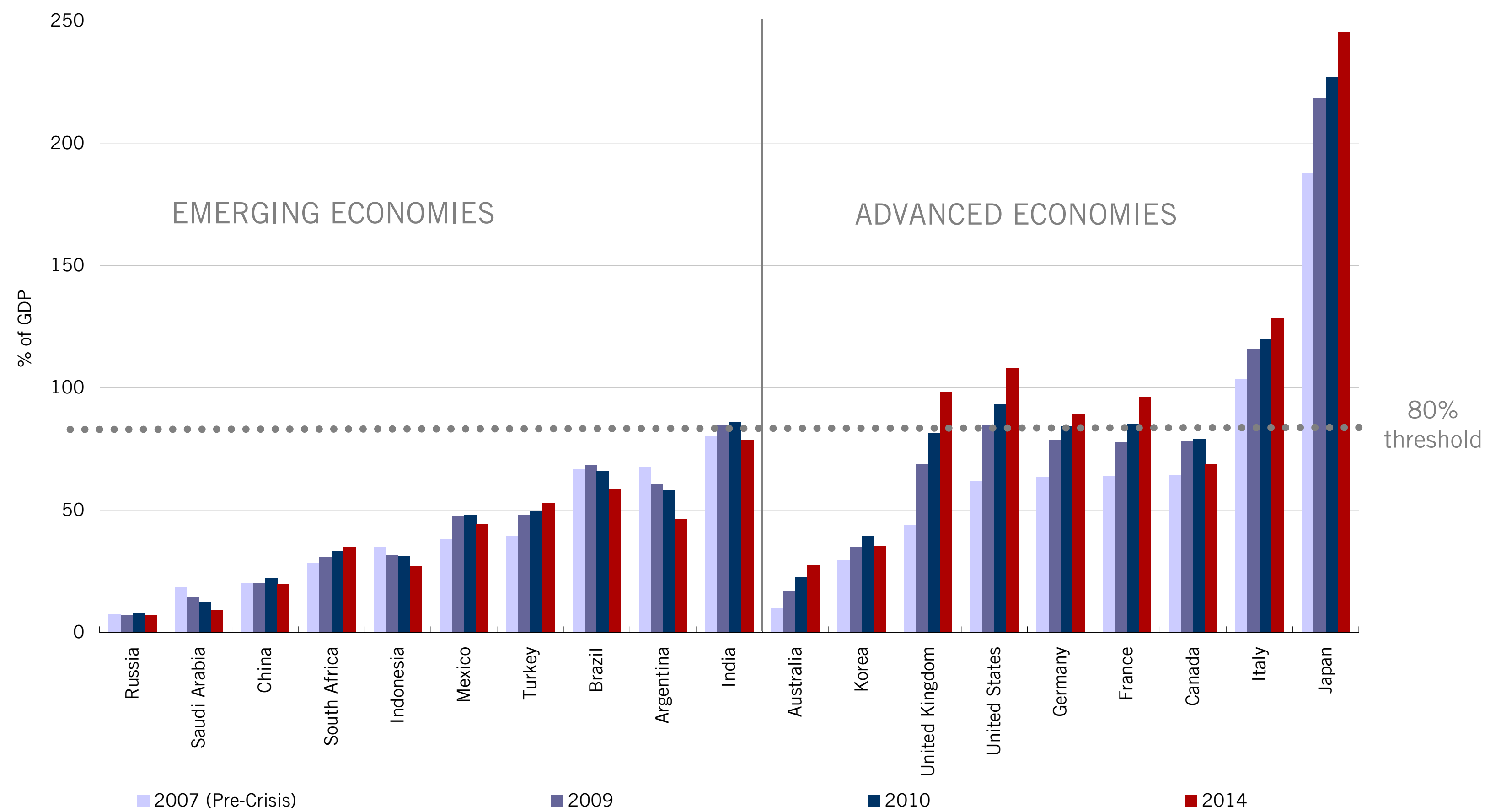
Government borrows cheaper than swap rates

Government borrows higher than swap rates

A surge of government debt

- Over the long-term, the debt dynamic remains very negative for Developed economies versus Emerging ones.
- In addition, most EM central banks reserves are higher than before the crisis.

PROJECTION OF DEBT TO GDP RATIO FOR THE G20 ECONOMIES

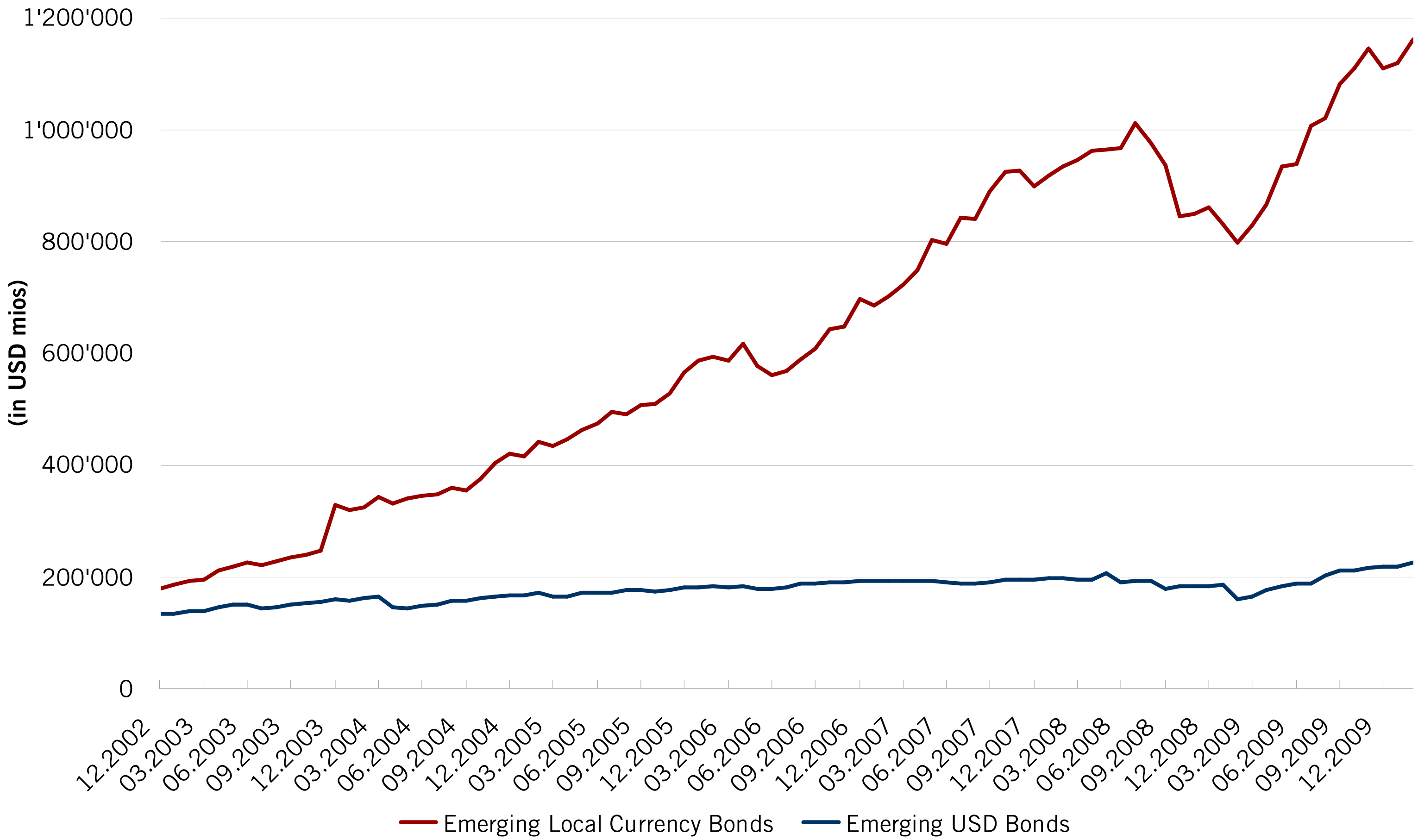


Source: IMF report on the state of public finances, Updated 2009-11-03

The reality of asset class growth

High growth in local bonds versus stagnation in USD bonds

MARKET VALUE IN MIO USD



Indices: JP Morgan GBI-EM Broad Diversified, JP Morgan EMBI Global Diversified

Source: JP Morgan, from 31.12.2002 to 28.02.2010

Conclusion: Asset Allocation change

- For Enhanced grids, we fund EM debt out of Investment Grade bonds.
- **Short-term liquidity conditions for EM debt may be difficult around Easter days.**
- For 2-3 &4 grids, the position is funded out of gvt. Bonds.
- We reallocate the 5% $ cash to the reference currency for non US grids.

	E	2	3	4
CHF	IG: -5% EM debt: +5%	Gvt bond: -5% EM debt: +5% Cash USD: -5% Cash CHF: +5%	Gvt bond: -5% EM debt: +5% Cash USD: -5% Cash CHF: +5%	Gvt bond: -8.5% EM debt: +5% Cash USD: -5% Cash CHF: +5%
EUR	IG: -5% EM debt: +5%	Gvt bond: -5% EM debt: +5% Cash USD: -5% Cash EUR: +5%	Gvt bond: -5% EM debt: +5% Cash USD: -5% Cash EUR: +5%	Gvt bond: -8.5% EM debt: +5% Cash USD: -5% Cash EUR: +5%
USD	IG: -5% EM debt: +5%	Gvt bond: -5% EM debt: +5%	Gvt bond: -5% EM debt: +5%	Gvt bond: -7.8% EM debt: +5%
GBP	IG: -5% EM debt: +5%	Gvt bond: -5% EM debt: +5% Cash USD: -5% Cash GBP: +5%	Cash EUR: +5% Gvt bond: -5% EM debt: +5% Cash GBP: -5%	Gvt bond: -8.2% EM debt: +5% Cash USD: -5% Cash GBP: +5%

Fixed income conclusions

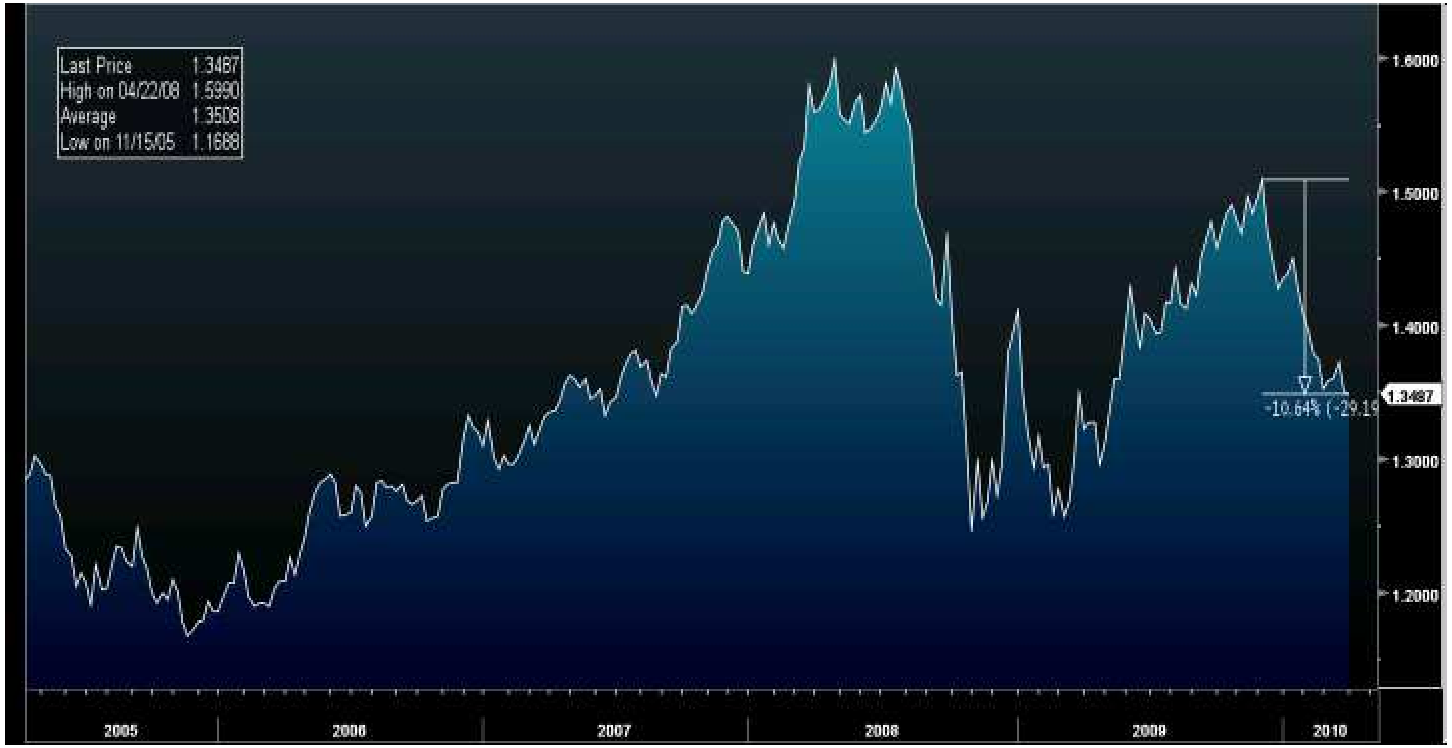
- Short-term, cyclical indicators point to higher and better quality growth in the US and a stagnation in Europe.
  - Bond spreads will therefore continue to widen between the two regions
- The US domestic capacity to absorb new government issues remain elevated as the domestic savings rate remains positive and the government is the only issuer of debt.
- Corporate spreads have continued to compress and now offer less compelling valuations.
  - We take some profits in Enhanced Grids where the IG position is high.
- Over the long-term, the debt dynamic will be very different between Developed economies and Emerging ones. Favour EM debt.
  - We initiate a 5% position in Local Currency Emerging Debt.
  - It is a structural call on the fiscal situation of these countries as well as the currency trend (what happens after the € crisis ?).

Equities conclusions

- When measured in local currencies, major equity markets performance has been pretty much the same, but smaller and riskier stocks relative performance has come to an extreme relative to large caps.
- Markets are not expensive, big, well-managed and boring companies are cheap and should outperform. Markets are overbought short-term.
- We may see more underperformance in EM as monetary policies are tightened meanwhile this risk has mostly disappeared in developed markets due to fiscal tightening.
- Valuations may compress, leading to a 10-15% performance in major equity markets...in local currency.

Eurodollar: back to fundamentals

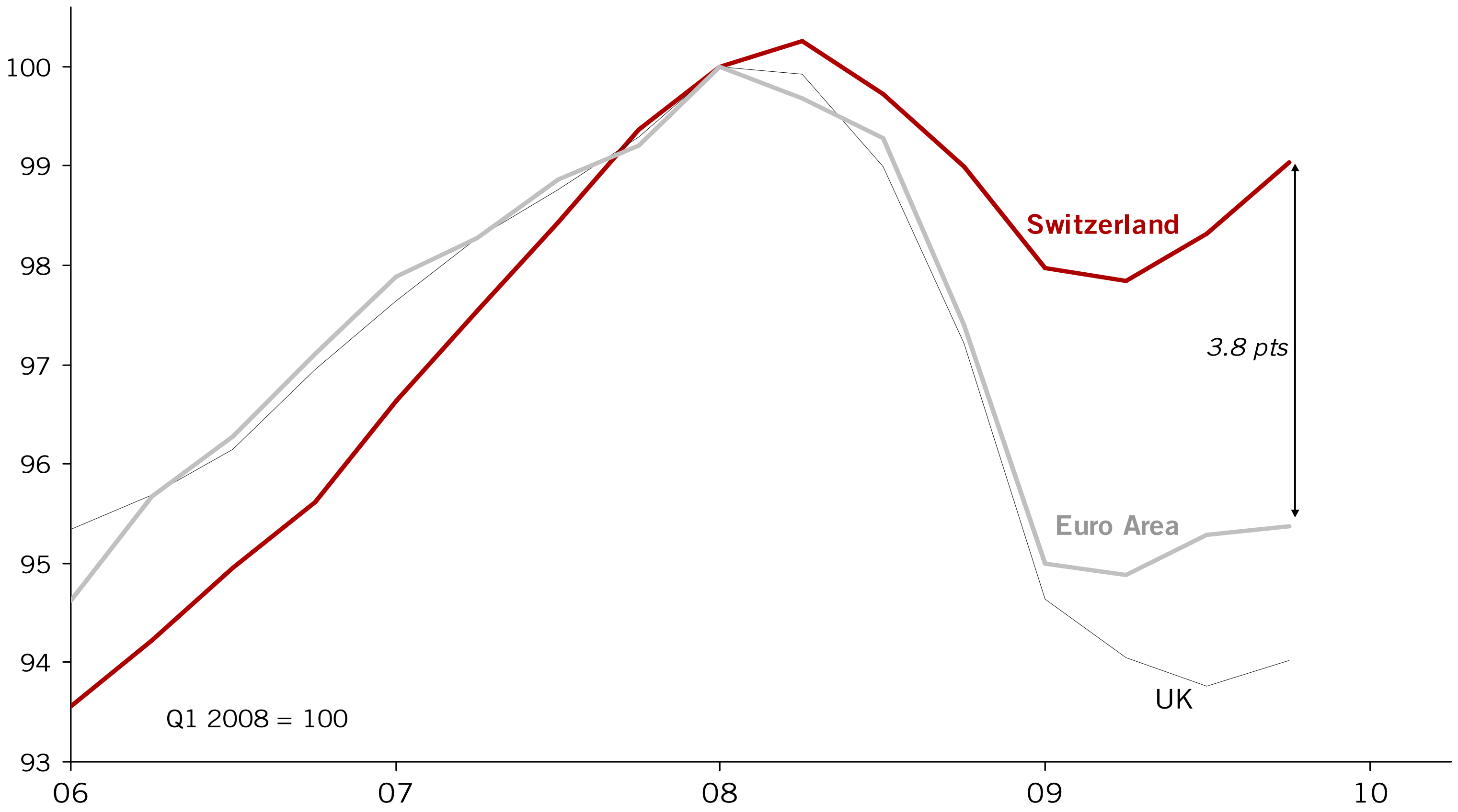
- The foreign exchange market has recently been trading on economic fundamentals (US versus Europe, CHF versus Europe).
- The cost of borrowing for many countries remain well above their nominal growth, maintaining a very low Eurozone growth.
- As we have all become Greece specialists, most of the € decline is probably already in the price. We expect 1.25 – 1.30 at year end.



By European standards, the Swiss economy performed…

- …less badly during the 'Great recession' and better during the recovery
- This has allowed a more flexible currency policy by the SNB, allowing the CHF to rise by 6% in 2010,

REAL GDP LEVELS: Q1 2008 = 100



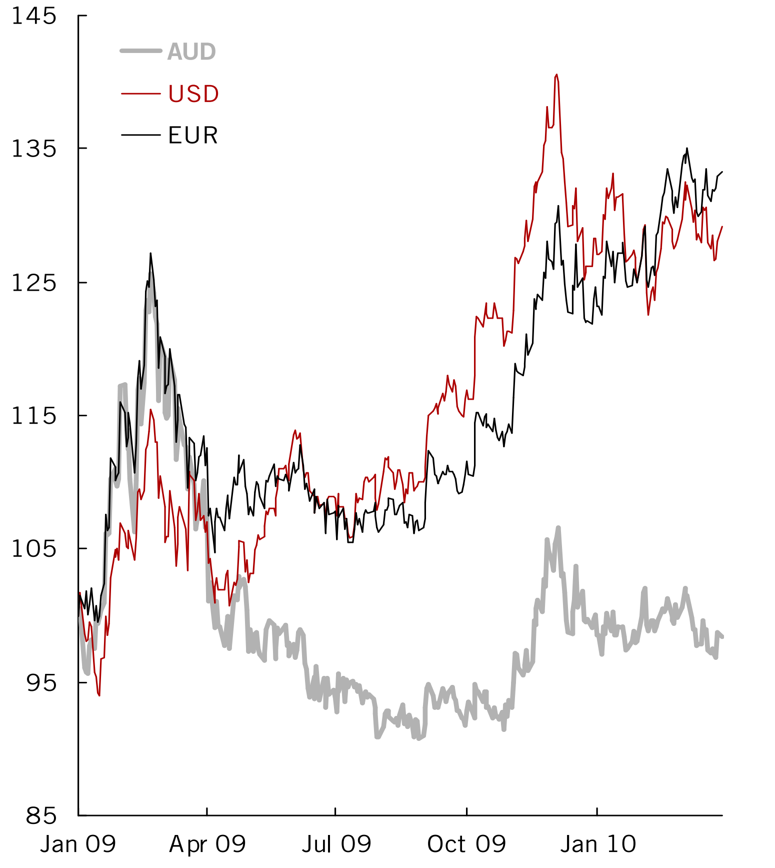
USD/EUR exchange rate

- On the back of (1) much more upbeat economic data in the US, (2) the emergence of euro-zone sovereign debt crisis and (3) temporary higher risk aversion, **the dollar rebounded sharply against the euro over the past 4 months or so**
- With some return of confidence regarding the Greek crisis and a strong come back of risk appetite, **the dollar registered some downward correction** during March first fortnight. However, the euro rebound was **quite muted** and very short-lived
- Over the near term, ups and down regarding market perception on the Greek debt crisis should continue to have a noticeable influence on the USD/EUR rate but, **on an end-of-year perspective, we remain rather bullish on the dollar**: (1) the US recovery will continue to outstrip that of Europe; (2) expectations on future Fed rate hikes will likely increase gradually; (3) movements in long-term rate differentials should reflect all that. As a result, **we believe that, although some other temporary downward correction may well occur at some stage or the other, the dollar will rise over the coming 9 months, reaching some USD1.25-1.30 to EUR1 by year-end**

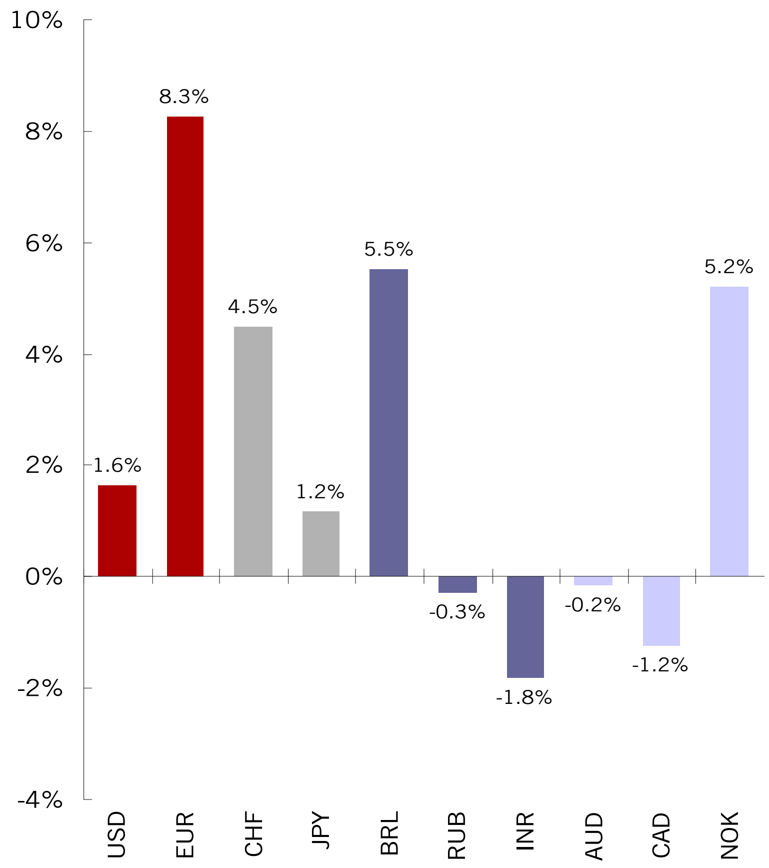
Gold

- Gold continues to outperform other currencies.
- The current environment (sovereign, fiscal, currency issues) make it a key asset.

GOLD PRICE IN SELECTED CURRENCIES



GOLD PRICE YTD PERFORMANCE (as of 29.03.10)



Wrap-up and conclusions

- Sovereign issues have become markets' main concerns. As growth remains fragile, the Fed and the ECB have to postpone their exit strategies.
- As most of the shocks were taken by currencies, equity markets are facing low interest rates, low valuations and rising earnings. We should therefore achieve our 2010 10-15% target return. <u>Stay in your reference currency</u>.
- Corporate bonds have lost some of their attractiveness as spreads are very thin. Their coupon remain, nevertheless above government yields.
- Government bonds are close to fair value based on fundamentals, but uncertainties related to market absorption remain. Over the long-term EM debt is favored.
- With all questions related to coming sovereign issuance and currency valuation, gold remains a key asset and continues to perform well against G7 currencies.

Conclusions and recommendations

Fixed income

- EU and US govies reduced from 14% to 9%.
- Build a 5% position in EM local currency debt
- Credit corporate narrowed but still attractive versus govies.

- Top picks:
  - Medium term govies.
  - IG grade max 5-year well diversified.
  - EM local currency fund
  - US HY hedged.

Conclusion and recommendations

Equities

- Sideways markets.

- Top picks:
  - US markets.
  - Large and boring companies
  - Renewable energy.

Conclusion and recommendations

Currencies

- FX driven by carry trade, capital flows and credit risk.
- Gold is in a primary uptrend against all paper currencies.

- Optimal blend:
  - Reference currency.
  - Gold.

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